BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

---------In the Matter of-------)	DOCKET NO. 2008-0274
PUBLIC UTILITIES COMMISSION)	
Instituting a Proceeding to Investigate Implementing a Decoupling Mechanism for Hawaiian Electric Company, Inc., Hawaii Electric Light Company, Inc., and Maui Electric Company, Limited.)	FILED 2009 MAR 30 P 3:19 PUBLIC UTILITIES COMMISSION

THE DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT, AND TOURISM'S OPENING STATEMENT OF POSITION ON A DECOUPLING MECHANISM FOR HECO/HELCO/MECO

AND

CERTIFICATE OF SERVICE

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THE DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT, AND TOURISM'S OPENING STATEMENT OF POSITION ON A DECOUPLING MECHANISM FOR HECO/HELCO/MECO

The Department of Business, Economic Development, and Tourism ("Department" or "DBEDT"), by and through its Director ("Director") in his capacity as the Energy Resources Coordinator, through the undersigned Deputy Attorney General, hereby submits to the Hawaii Public Utilities Commission ("Commission" or "PUC") its Opening Statement of Position (OSOP) on the decoupling mechanism for HECO, HELCO, and MECO, pursuant to the PUC Order approving the procedural schedule issued on January 21, 2009. DBEDT reserves the right to modify its initial position based on additional information that may come to light or be provided by the parties in the instant docket during the course of this proceeding.

The PUC Order initiating this investigation on the implementation of a decoupling mechanism in the service territories served by the HECO Companies cited the Energy Agreement entered into between the State and the HECO Companies on October 20, 2008, as the basis for initiating the instant docket. The Energy Agreement provides that "the parties agree in principle that it is appropriate to adopt a decoupling mechanism that closely tracks the mechanisms in place for several California electric utilities…"[1] This agreement in principle by the parties did not provide detailed guidance on the design of a decoupling mechanism that is appropriate, reasonable, and in the public interest, but instead left those design details to the evaluation and approval process of the PUC for the implementation of a decoupling mechanism such as this proceeding.

A decoupling mechanism is a utility ratemaking regulatory tool that eliminates or reduces the inherent disincentives of traditional ratemaking to promote energy efficiency, conservation, and the increased use and development of renewable energy resources that impact the utility's kilowatt-hour sales. Since utility revenues (and therefore, profits) are linked to its sales, the traditional ratemaking framework inherently provides financial incentives for the utility to increase rather

[1] Energy Agreement, October 20, 2008, item 28, page 32. Underscore added.

than decrease its kilowatt-hour sales. A decoupling mechanism de-links or disassociates the utility's revenues (and profit) from the utility's sales, making the utility indifferent to changes in its sales volume resulting from greater energy efficiency and other demand-side programs that reduce the utility's sales volume.

The intent of the Energy Agreement was to remove the barriers to the utility to aggressively pursue and promote demand-side programs (such as demand-response programs and energy efficiency programs), customer-owned and third-party-owned renewable energy systems and technologies, as well as to increase the use of renewable energy resources in the utility generation portfolio to help achieve the HCEI goal of transforming Hawaii to 70% renewable energy-based economy by 2030. DBEDT's preferred decoupling mechanism is therefore one that is designed to achieve the HCEI goal while preserving the utility's financial integrity. This means a decoupling mechanism that compensates the utilities for the lost revenues (and earnings) resulting from the effects of utility activities and programs that are related to promoting and achieving the HCEI goals.

DBEDT recognizes the difficulty of identifying and segregating the impact of the utility activities and programs that are related to achieving the HCEI goals from the effects of other factors, such as the economy or weather, on the utility's revenues and earnings. It is not however DBEDT's or the HCEI's intent to implement a decoupling mechanism that simply insulates the utility from all market risks and provides a guarantee for recovering 100% or more of its allowed return, and shifting all those risks (such as the effects of the current economic downturn) to the ratepayers. It is also neither DBEDT's nor the HCEI's intent to implement a decoupling mechanism that simply provides an automatic annual unlimited rate increase to the utility.

DBEDT believes that a reasonable decoupling mechanism that is based on a method agreed to in principle by the parties to the Energy Agreement should include but not be limited to the following considerations:

1) The operation and maintenance costs ("O&M costs") that will be escalated based on some cost indices (as determined by the Commission) should exclude the following without limitation:

    (a) fuel and purchased power costs that are recovered from automatic rate adjustment clauses;
    (b) labor costs;
    (c) depreciation and amortization;
    (d) interest on customer deposits;

(e) uncollectibles;

(f) pensions and other post-retirement benefits expense;

(g) utility expenses recovered through separate surcharges;

(h) some miscellaneous A&G expense such as community service activities and company membership dues, and other similar expenses that the PUC and/or the Consumer Advocate (CA) may deem not appropriate or reasonable to include, as they are not related to nor affected by the utilities' activities relating to the Energy Agreement or to HCEI.

2) The rate base adjustments should only include the portion of the utility's plant-related expenditures that are related to the utility's commitments under the Energy Agreement and that are not recovered through separate surcharges. The Commission may also consider imposing a cap on the amount of plant addition expenditures included in the annual rate base adjustments.

3) The cost indices should be those that are reasonable and applicable to Hawaii, and consistent with the indices that are used by the HECO Companies to estimate the O&M costs for rate case purposes.

4) Consideration of the elements in the CA's RAM Conceptual Framework Proposal that afford ratepayers protection, such as the suggested earnings sharing mechanism.

5) Consideration of other provisions that safeguard the ratepayers' interest, such as a cap or limit on the increase in the total target revenue requirements, or a cap on the percent rate adjustment implemented each year.

6) Consideration of the impact on the HECO Companies' revenues and earnings of all the other incentives provided in the Energy Agreement, subject to PUC approval, such as the timely recovery of utility expenditures related to renewable energy resources through the Clean Energy Infrastructure Surcharge (CEIS); the recovery of the purchased power costs, including the purchased capital cost, through a surcharge mechanism similar to ECAC; and the commitment in principle by the parties to the Agreement to support ratebasing of 10% of the purchased power through feed-in tariffs.

7) Consideration of modifying ECAC such that the performance incentives currently built into the ECAC calculation be modified or eliminated if decoupling is enacted.

8) Adjusting the target revenue requirements based on performance metrics related to the achievement of the

HECO Companies' commitments under the Energy Agreement. Such performance metrics may include but not be limited to: (1) the number of new net energy metered customers interconnected to the system during the year; (2) the increase in nonfossil-based kilowatt-hour generation during the year; (3) the increase in the number of customers signed up in the Pay-as-You-Save Solar Program during the year; (4) the amount of new renewable energy (kilowatt-hours) purchased through the feed-in tariffs during the year; (5) the decrease in the amount of fossil oil used during the year; and (6) the increase in the energy savings (kWh) resulting from energy efficiency programs and demand-side programs.

9) The calculation of any decoupling rate adjustment mechanism must be transparent and easy to understand.

10) The decoupling mechanism must include detailed and transparent reporting by the utility on an annual basis, and preserve the PUC's authority to evaluate its effectiveness and impact, as well as the PUC's authority to terminate the mechanism at any time.

HECO's Proposed Decoupling Mechanism

On January 30, 2009, the HECO Companies filed their Revenue Decoupling proposal pursuant to the PUC Order initiating the instant docket issued on October 24, 2008, and the PUC Order approving the procedural issues and schedule to govern the proceeding.

The HECO Companies' filing states:

> " As the HCEI Agreement recognizes, utility costs and the need to make investments in infrastructure are likely to increase each year. Under traditional ratemaking, sales increases between rate cases provided the utility the opportunity to recover the associated cost increases. However, setting a target revenue requirement that does not change between rate cases under sales decoupling provides no compensation to the utility for increases in utility costs or infrastructure investments. Therefore, there is a need to allow increases in the target revenue requirement level each year. This is accomplished through the revenue adjustment mechanism or "RAM".[2]"

The above cited statement provides HECO's policy basis for the HECO Companies' proposed Revenue Adjustment Mechanism ("RAM") for a decoupling method. Based on DBEDT's understanding of the HECO Companies' filing and on the HECO presentations during the February 27, 2009 Technical Workshop, the essential elements of the HECO Companies' RAM proposal are summarized as follows[3]:

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[2] Docket No. 2008-0273. The HECO Companies' Revenue Decoupling Proposal, Transmittal Letter, January 20, 2009, at 2. Underscore added.

[3] HECO's proposed decoupling method is the same for HECO, HELCO, and MECO.

1. Use the PUC-allowed revenue requirements from HECO's 2009 test-year rate case as the baseline.

2. Determine target revenue requirements in between rate cases based on a "hybrid" method. Under this method, the changes in the O&M expenses are determined by escalating the base year O&M non-labor costs (excluding fuel and purchased power expense, and including interest on customer deposits) using the forecasted utility cost indices from Global Insight Inc. The O&M labor costs are escalated using the union contractual wage rate increases.

3. The estimated changes to the rate base are determined by extrapolating the 1996-2007 recorded average rate base using the linear trend method and then adding the <u>full costs</u> of the "significant plant additions" from the HECO Companies' capital budget forecast PLUS 10%.[4]

4. After determining the estimated target changes to the O&M costs and rate base, the total revenue requirements (i.e. for year 2010) are calculated using the allowed rate of return on rate base, and maintaining the depreciation and amortization and income taxes constant at the baseline 2009 levels.

5. The difference between the estimated post test year target revenue requirements (i.e. 2010) and the allowed test-

[4] HECO's Decoupling Proposal. January 30, 2009, pages 28, 31.

year revenue requirements (2009) is the amount of target revenue increase or the Revenue Adjustment Mechanism (RAM).

6. The target revenue increase is then allocated between the residential class and the non-residential classes (Schedules G, J, Ps, and F - all combined in one sector) based on kilowatt-hour (kWh) sales. The rate adjustment (¢/kWh) is determined simply by dividing the allocated target revenue increase and the classes' forecasted kWh sales.

7. The actual revenues collected and target revenues are compared on an annual basis, and the difference, including accrued interest based on the allowed rate of return on rate base, is then added/subtracted to the following year's (i.e., 2011) calculated RAM using the same hybrid method. A significant detail in the HECO Companies' proposal is the use of the estimated target revenue requirements for the prior post test year (i.e. 2010) as the base for the following post test year (i.e., 2011) rather than the test-year baseline (2009). This method results in compounded annual rate increases. This cycle is repeated until the utility files a rate case.

DBEDT's Comments on HECO's Decoupling Proposal

The HECO Companies noted in their submittal that their decoupling mechanism proposal is "preliminary and is intended to facilitate discussion", and that they "... may refine their

Decoupling Mechanism proposal in their Initial Statement of Position to be submitted March 30, 2009…"[5] Based on this understanding, DBEDT's initial position and comments on HECO's decoupling proposal are summarized below:

1. The HECO decoupling mechanism proposal is unreasonable, as it will result in automatic annual unlimited rate increases. It insulates the utility from all the market risks and provides a guarantee for recovering 100% or more of its allowed return. It shifts all the risks to the ratepayers, such as the effects of the current economic downturn, which is unrelated to the utility achieving its commitments under the Energy Agreement.

2. HECO's proposed cost indices for adjusting its O&M costs are without basis. Based on materials shared by HECO during the February 27, 2009 Technical Workshop, it appears that the Global Insights utility cost indices proposed by HECO are significantly higher than the other cost indices, such as the Honolulu CPI-U and the Gross Domestic Producers Price Index (GDPPI) which HECO normally uses in forecasting their O&M costs for rate case purposes. HECO has never used the Global Insights indices in forecasting its O&M costs for rate case purposes. During the February 27, 2009 Technical Workshop, the only reason

[5] Docket No. 2008-0273. The HECO Companies' Revenue Decoupling Proposal, Transmittal Letter, January 20, 2009, at 2.

HECO cited for proposing to use the Global Insights indices is that they are used in California. DBEDT believes that California's use of the Global Insights indices is not a reasonable basis for using the same indices for a decoupling mechanism for the HECO Companies. More importantly, when asked during the February 27, 2009 Technical Workshop, it was revealed that even HECO does not know how these cost indices are derived or determined.

3. HECO's decoupling proposal does not include provisions for any consumer protection. It simply provides the utilities with automatic annual unlimited rate increases, irrespective of the impact on ratepayers.

4. The HECO proposal does not include any provisions for performance measures. It simply allows the HECO Companies automatic annual rate increases, regardless of whether or not the utilities are fulfilling their commitments under the Energy Agreement, thereby reducing their kWh sales.

5. DBEDT is concerned that the HECO Companies' proposal, which simply escalates their O&M costs on a formulaic basis, does not provide any incentive for the utilities to manage their costs. DBEDT believes that HECO's decoupling proposal would actually create a disincentive for utilities to manage costs.

6. DBEDT believes that escalating all elements of their O&M costs regardless of whether they are in fact related to or

impacted by the utilities' activities relating to the Energy Agreement or HCEI is unreasonable and is not in the public's best interest.

7. HECO's proposed method for determining the changes in the rate base is also of concern to DBEDT. The proposed method effectively escalates all the elements in the rate base, which include non-plant related items such as the unamortized system development costs related to the development of HECO's Human Resources Suite system and Customer Information System, and working cash. These rate base items are not and will not be impacted by HECO's activities relating to the Energy Agreement or to HCEI. Additionally, the fuel inventory included in the rate base should be reduced, rather than maintained at the 2009 baseline level, due to the supposed impact of the HECO Companies' activities to reduce the utilities' fossil-fuel use.

CA's Proposed Decoupling Mechanism

The PUC Order initiating the instant docket directed the HECO Companies and the CA to file a joint decoupling mechanism proposal. On January 30, 2009, both parties filed their separate decoupling mechanism proposals. Similar to HECO's submittal, the CA's submittal of its proposed Rate Adjustment Mechanism (RAM) is a discussion draft offered to stimulate dialoque around the many complex issues and does not represent the final position of the CA.[6]

Based on DBEDT's understanding of the CA's filing and based on the CA's presentation during the February 27, 2009 Technical Workshop, the essential elements of the CA's RAM proposal are summarized as follows:

1. O&M non-labor costs, excluding those costs recovered from separate surcharges (i.e., ECAC), are escalated using the GDPPI minus a productivity offset of 0.76%. The O&M labor costs are escalated using the union contractual wage rate increases.
2. The estimated changes to the rate base are based on the net plant in-service additions categorized into two parts: (a) the "baseline plant in service" based on the historical average of completed plant investments for the preceding five years (i.e., 2004-2008), and (b) the major capital improvement projects that have been approved by the PUC in docketed proceedings and not yet included in ratebase, but with virtual certainty of completion within the first half of the RAM period.

[6] CA's HECO/MECO/HELCO Rate Adjustment Mechanism "RAM" Conceptual Framework Proposal, January 30, 2009, at 4.

3. The estimated RAM includes the estimated changes in the O&M costs including the actual calculated depreciation and amortizations, and return on the estimated changes to the rate base net any plant-in-service component, including CIAC and deferred income taxes.

4. A significant element of the CA's proposal is a provision for an earnings sharing mechanism similar to the HECO proposal in Docket No. 99-0396. This earnings sharing mechanism will credit the ratepayers with a certain percentage of the HECO Companies' earnings achieved above their allowed rate of return.

<u>DBEDT's Comments on the CA's Proposed Decoupling Framework</u>

The CA's proposed decoupling framework is very cognizant of the potential rate increase impacts of a decoupling mechanism, and DBEDT shares this cognizance. The proposal incorporates some consumer protection features which DBEDT supports as important to ensure that the implementation of a decoupling mechanism is not simply to insulate the HECO Companies from all the market risks, and at the same time shift all the risks to the ratepayers.

Conclusion

In summary, DBEDT believes that the implementation of a decoupling mechanism is important in encouraging the HECO Companies to promote the increased use and development of energy efficiency and renewable energy to help achieve Hawaii's energy goals of energy independence and security with its attendant economic and environmental benefits. DBEDT is cognizant of the importance of recognizing the potential impacts of all the other incentives and regulatory mechanisms that are provided in the Energy Agreement, subject to PUC approval, on the HECO Companies' revenues and earnings, in designing a decoupling mechanism. DBEDT believes that any decoupling mechanism adopted and approved by the Commission should include consumer protection features as well as performance metrics such as those suggested by DBEDT herein.

DATED: Honolulu, Hawaii, March 30, 2009.

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Certificate of Service

I hereby certify that I have served a copy of the Department of Business, Economic Development, and Tourism's Initial Statement of Position on a Decoupling Mechanism for HECO, HELCO, and MECO, in Commission Docket Number 2008-0274, by electronic transmission on the date of signature to each of the parties listed below.

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